

The Professional Privilege Tax in Tennessee: Taxing Professionals Fairly

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Eliminating the Professional Privilege Tax in Tennessee Would Address Some Inequities but Would Primarily Benefit Out-of-State Professionals

Tennessee's professional privilege tax, enacted in 1992 as a part of a \$276 million tax increase, taxes individuals in 22 professions at a rate of \$400 per year. The tax was passed to help provide revenue to restore spending that was cut in the wake of the 1990-91 recession and to begin the phase-in of the Basic Education Program, the state's education funding formula. The administration initially tried to raise this revenue by asking the legislature to pass an income tax, and when that failed, the legislature tried to instead broaden the sales tax to include more services. When that also failed, a compromise measure was passed that included an increase to the sales tax rate and enactment of the professional privilege tax. At the time, the professional privilege tax was only \$200 per year per professional, but it was doubled to \$400 per year as part of a \$933 million tax increase in 2002.

It is difficult to objectively determine where to draw the line on which professions should be taxed and which shouldn't; the original decision on which professions to tax was driven largely by the amount of revenue including each would raise and on whether the profession had high average salaries. When passed in 1992, the professional privilege tax was applied to 21 professions:

accountants, architects, attorneys, audiologists, chiropractors, dentists, engineers, investment advisers landscape architects, lobbyists, , optometrists, osteopathic physicians, pharmacists, physicians, podiatrists, psychologists, real estate principal brokers, speech pathologists, stockbroker agents, stock broker-dealers (stockbrokers), and veterinarians.

Athlete agents were added in 1996, bringing the total number of professions taxed to 22. Major league professional basketball and hockey players were added to the list of professions taxed in 2009, but at a rate of \$2,500 per game, up to three games. But, legislation was passed in 2014 exempting these players. Certain individuals within the 22 taxed professions are exempted, including inactive or retired professionals, those called into active military service from a reserve or National Guard unit for more than six months, non-professional lobbyists, and medical practitioners licensed to volunteer at free health clinics. Of the 220,050 professionals who pay the tax, two-thirds (141,048) live outside the state.

Over the years, legislators and representatives of various professions have argued that Tennessee's professional privilege tax is not equitable, saying that some professions that are not taxed have higher incomes than those that are taxed, that incomes of professionals vary significantly within the taxed professions, and that those in professions earning lower salaries have to pay the same amount as those earning more. Salary data supports these arguments. For example, the lowest 10% of stockbroker agents by salary earn less than \$29,110 per year, and the highest 10% earn more than \$179,810, but all pay the same \$400 tax. And nurse anesthetists, the highest earning profession that is not taxed, average \$153,690 per year in salary in Tennessee, which is greater than that of 20 of the 22 professions that are taxed.

Further, after the General Assembly passed legislation in 2000 extending franchise and excise taxes to limited liability entities, some professionals that organize their businesses as limited liability corporations, limited partnerships, or limited liability partnerships and also pay the professional privilege tax argued that they were being double-taxed. Although no legislation has been introduced to specifically address this concern, a common approach in such instances with other taxes is to provide a credit for one of the taxes against the other.

The concerns with the professional privilege tax prompted legislation in 2015, Senate Bill 556 by Bowling, House Bill 678 by Van Huss, which would have phased out the tax over five years. The bill was amended in 2016 and became Public Chapter 1024, which instead directed the Commission to study

- the history of the professional privilege tax in this state,
- the intent of the professional privilege tax,
- other states' laws imposing a professional privilege tax or similar tax, and
- alternatives for eliminating or phasing out the professional privilege tax.

The Act also directed the Commission to study the original language of Senate Bill 556 and House Bill 678, as well as Senate Bill 1919 by Bowling, House Bill 1951 by Hazlewood, which would have exempted some out-of-state professionals, and Senate Bill 167 by Bowling, House Bill 601 by Durham, which would have exempted audiologists and speech pathologists from the tax.

Only five other states—Alabama, Connecticut, Delaware, Montana, and North Carolina—have a professional privilege tax. Alabama's and Delaware's privilege tax rates vary by profession, while the other three states have a flat rate like Tennessee. Montana's and North Carolina's rates are lower, \$25 and \$50, while Connecticut's is much higher at \$565. The list of professions taxed varies across the six states, but most of them tax at least real estate brokers and attorneys. Connecticut and Montana's professional privilege tax applies only to attorneys.

Texas used to levy a privilege tax but eliminated it in 2015, in part in response to similar concerns to those in Tennessee about double taxation with the privilege tax and the franchise and excise tax. If Tennessee were to eliminate its tax all at once as Texas did, it would cost the state an estimated \$88 million a year in revenue. If instead the tax were phased out over five years as it would have been by the original version of Senate Bill 556, House Bill 678, state revenue would decrease by \$17.6 million in the first year and by \$264 million over five years. This is \$176 million less over the five years than the total decrease from eliminating the tax all at once; extending the phase-out period over a longer time would reduce the cumulative loss in revenue further. Of the \$264 million in reduced revenue, only about a third (\$95 million) would be to the benefit of Tennessee professionals. The other \$169 million would be from revenue raised by the tax on professionals who live outside Tennessee.

Rather than eliminating the entire tax, the two additional bills referred by Public Chapter 1024 would have exempted certain individuals or professions. According to its fiscal note, Senate

Bill 1919, House Bill 1951, would have exempted just 705 of the 141,048 out-of-state professionals, specifically those who are licensed or otherwise allowed to practice in another state but who do not maintain a residence or place of business in the state and who do not work in Tennessee in one of the taxed professions. According to the fiscal note, this would cost the state \$282,000 per year.

Senate Bill 167, House Bill 601, by exempting the 350 audiologists and 1,954 speech pathologists subject to the tax, would have cost the state an estimated \$930,000 in lost revenue per year. A similar bill, Senate Bill 372 by Crutchfield, House Bill 286 by McDonald, was introduced in 2004 but failed. The legislature has tried to exempt other specific groups of professionals over the years, but these efforts have also failed. These include legislation that would have removed those who only practice professionally on a volunteer basis, health care providers serving in a residency or in graduate studies, certain military medical officers, medical practitioners who exclusively provide pro bono services, dentists older than 75, and disabled persons who are not actively employed. Also, the legislature considered a bill that would have exempted individuals with incomes of less than \$5,000 per year derived from their profession. Other states exempt or partially exempt blind people, disabled veterans, World War II veterans, and people aged 75 years or older.

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Tennessee is One of Just a Few States with a Professional Privilege Tax

Tennessee is one of only six states that imposes a professional privilege tax, the others being Alabama, Connecticut, Delaware, Montana, and North Carolina. The privilege tax in each of these states is imposed in addition to license fees. For example, architects pay \$140 every two years to renew their Tennessee licenses.¹ All of these states except Tennessee also tax personal income. Tennessee’s professional privilege tax is the newest and collects the most revenue.² See table 1.

Table 1. States with Professional Privilege Taxes

State	Amount of Annual Tax	How much it raised	Date Created
Alabama	Varies by profession	\$5 million (FY 2013-2014)	1935
Connecticut	\$565 (attorneys only)	\$9 million (FY 2014-2015)	1972
Delaware	Varies by profession	\$6.9 million (FY 2014-15)	1915
Montana	\$25 (attorneys only)	\$115,000 (FY 2011-2012)	1917
North Carolina	\$50	\$41 million (FY 2014-2015)	1939
Tennessee	\$400	\$102 million (FY 2014-2015)	1992

Sources: 2015 A Legislator’s Guide to Alabama’s Taxes. Connecticut Department of Revenue Services Fiscal Year 2015-16 Annual Report. Email from Delaware Revenue Division. 2012 Supreme Court of Montana, Report on Annual License Tax on Attorneys. The Governor’s Recommended Budget 2016, North Carolina. Tennessee Department of Revenue Collections Data.

Tennessee and three of the other five states have a single rate that does not vary by profession. The rate in Tennessee is \$400 per year for each filer.³ Connecticut’s is higher at

¹ <https://tn.gov/commerce/article/arch-fees>

² Tennessee Code Annotated, Section 67-4-1702.

³ Tennessee Code Annotated, Section 67-4-1703.

\$565,⁴ but the other two's are much less; Montana's tax is \$25,⁵ and North Carolina's is \$50.⁶ The taxes in the other two states, Alabama⁷ and Delaware,⁸ both vary by profession, and Alabama's also varies by location and other factors. Delaware's varies from \$10 per plot for a person operating a trailer park to \$5,000 per year for one member of a headquarters management corporation. In Alabama, the tax can be more if the work is performed in a city rather than in an unincorporated area, and in some cases, can be more in larger cities than in smaller ones. Alabama's tax amount can also vary based on other factors, for example, the tax paid by a barbershop operator can vary based on the number of chairs in his shop. Alabama's tax amount ranges from three cents per ton of iron mined for a mining ore operator to \$500 per year for a beverage bottler. According to an official in the Alabama Legislative Fiscal Office, there's been discussion about replacing their privilege tax rate structure with a flat rate of \$300 or \$400 per filer, but no action has been taken.⁹ See appendix E for a complete list of privilege tax amounts per profession for each of the five states, as well as for the rates for the tax that was just repealed by Texas in 2015.¹⁰

Beginning in 1991, the year before Tennessee enacted its professional privilege tax, Texas imposed what amounted to a professional privilege tax of \$200 per year on licensed professionals. The Texas tax was enacted as a fee increase on professional fees, but 75% of the revenue was earmarked for the general fund, and 25% was earmarked for a specific school fund.¹¹ The Texas Supreme Court has held that if the primary purpose of a fee is to raise revenue the fees are taxes.¹²

Texas eliminated their tax completely in 2015 in response to arguments by various groups representing professionals that the tax amounted to double taxation since professional

⁴ Connecticut Annotated Statutes, Section 51-81b.

⁵ Montana Code Annotated, Section 37-61-211.

⁶ General Statutes of North Carolina, Section 105-41.

⁷ Code of Alabama, Sections 40-12-41 et seq.

⁸ 30 Delaware Code Annotated, Section 2301 (a) and (b).

⁹ Kirk Fulford, House Fiscal Officer for the Alabama Legislative Fiscal Office, phone interview with Michael Mount, June 29, 2016.

¹⁰ 2015 Tex. HB 7.

¹¹ According to the 2015 Texas Comptroller Sources of Revenue Report, 25% of the tax on real estate professionals was earmarked for the Texas A&M University Real Estate Research Center Local Fund.

¹² In *Texas Boll Weevil Eradication Foundation v Lewellen*, 952 S.W. 2d 454 (1997), the Texas Supreme Court held that if "the primary purpose of the fees provided therein is the raising of revenue, then such fees are in fact occupation taxes, and this regardless of the name by which they are designated. On the other hand, if its primary purpose appears to be that of regulation, then the fees levied are license fees and not taxes."

businesses were also subject to the franchise tax.¹³ They said that most professionals weren't subject to the franchise tax when the privilege tax was passed in 1991, but they became subject to it when the franchise tax was expanded in 2006.¹⁴ However, franchise tax returns show that 90% of filers in Texas have no tax liability.¹⁵ Businesses with less than \$1 million in receipts or that owe less than \$1,000 in taxes are exempt.¹⁶ Similar concerns have been raised in Tennessee.

If Tennessee, like Texas, were to eliminate its tax all at once, annual state revenue would decrease by an estimated \$88 million.¹⁷ Rather than eliminating it all at once, the original version of Senate Bill 556, House Bill 678, would have phased out the tax over five years. With 220,050 professionals subject to the tax, this would decrease state revenue by \$17.6 million in the first year of the phase-out. Over five years, phasing out the tax would decrease state revenue by \$264.1 million over five years, which is \$176.0 million less than eliminating the tax all at once. Phasing it out over ten years would decrease state revenue by \$484.1 million over ten years, which is \$220 million less than with a five-year phase out and \$396.1 million less than eliminating the tax all at once. See table 2. Of the \$484.1 million in reduced revenue, \$310.3 million would be from lost tax revenue on professionals who live outside Tennessee and only \$173.8 million would be from reduced taxes on Tennessee professionals.

¹³ Batheja 2015.

¹⁴ Letter from 18 Texas professional groups to Representative Jane Nelson, May 7, 2015.

¹⁵ Ed Warren, Texas Comptroller's Office, phone interview with Stan Chervin, July 19, 2016.

¹⁶ Texas Tax Code 171.002.

¹⁷ The fiscal note of Senate Bill 556, House Bill 678, estimated state revenue decreasing by \$77.3 million in the fifth year of the phase out; however, that number was based on a 2015 estimate from the Department of Revenue of 200,000 professionals paying the tax. In 2016, the Department of Revenue estimated that the number of professionals paying the tax was 220,050, which results in an \$88 million decrease. Tax collections of \$102 million in fiscal year 2015 were greater than normal because of increased enforcement called for in Chapter 763, Public Acts of 2014. This legislation required taxpayers to be notified in writing that failure to pay professional privilege tax could result in license or registration suspensions.

Table 2. Phasing Out or Eliminating the Professional Privilege Tax
Decrease in State Revenue [in millions]

Year	5-Year Phase-Out		10-Year Phase-Out		Eliminate All at Once	
	Decrease in State Tax Revenue	Cumulative Decrease in State Tax Revenue	Decrease in State Tax Revenue	Cumulative Decrease in State Tax Revenue	Decrease in State Tax Revenue	Cumulative Decrease in State Tax Revenue
Year 1	\$17.6	\$17.6	\$8.8	\$8.8	\$88.0	\$88.0
Year 2	\$35.2	\$52.8	\$17.6	\$26.4	\$88.0	\$176.0
Year 3	\$52.8	\$105.6	\$26.4	\$52.8	\$88.0	\$264.1
Year 4	\$70.4	\$176.0	\$35.2	\$88.0	\$88.0	\$352.1
Year 5	\$88.0	\$264.1	\$44.0	\$132.0	\$88.0	\$440.1
Year 6	\$88.0	\$352.1	\$52.8	\$184.8	\$88.0	\$528.1
Year 7	\$88.0	\$440.1	\$61.6	\$246.5	\$88.0	\$616.1
Year 8	\$88.0	\$528.1	\$70.4	\$316.9	\$88.0	\$704.2
Year 9	\$88.0	\$616.1	\$79.2	\$396.1	\$88.0	\$792.2
Year 10	\$88.0	\$704.2	\$88.0	\$484.1	\$88.0	\$880.2

Source: TACIR staff calculations based on 220,050 professionals and a \$400 per year tax.

In addition to the double-taxation argument, legislators and representatives of various groups of professionals have over the years expressed concerns that Tennessee’s professional privilege tax is not equitable. They say this is because

- some professions that are not taxed have higher incomes than those that are taxed,
- incomes of professionals vary significantly within a profession, and those earning less pay the same tax as those earning more, and
- the tax burden falls mostly on out-of-state professionals.

Because some professions are taxed but others are not, another concern sometimes raised is that the tax violates the equal protection clause of the state and federal constitutions. The clauses require the state to have laws that treat an individual in the same manner as other people in similar circumstances. However, in two opinions, Tennessee’s Attorney Generals have written that the tax is not a violation of the equal protection clauses of the state and federal constitutions.¹⁸ Moreover, the US Supreme Court has held that states “may impose different specific taxes upon different trades and professions” and if a tax “is neither capricious

¹⁸ Office of the Attorney General of the State of Tennessee, 1992 Opinion No. 92-48 and 2004, Opinion No. 04-154.

nor arbitrary, and rests upon some reasonable consideration of difference or policy, there is no denial of the equal protection of the law.”¹⁹

The Professional Privilege Tax—A Response to State Revenue Needs

The professional privilege tax was enacted at a time when the state needed several hundred million dollars in revenue to fund the fiscal year 1992-93 budget. Spending was cut from the 1991-92 budget in the wake of the 1990-91 recession²⁰ and tax collections in fiscal year 1990-91 were \$233 million less than was estimated.²¹ Not only did legislators want funds to allow them to return spending to 1990-91 levels, but they also anticipated they would need funds to meet the requirements of a pending lawsuit. The state was being sued over inequity in education funding by a consortium of small, mostly rural school systems that filed in 1988. The state would go on to lose the case in 1993. The consortium argued that the old funding formula violated the Tennessee Constitution and that the state should be required to establish a new funding system that met constitutional standards.²² The funding formula for the state’s K-12 system that was developed, the Basic Education Program (BEP), would have cost more than \$500 million to fully fund in fiscal year 1992-93.²³

To address these funding challenges, Governor McWherter called a special session of the General Assembly in January 1992 to consider education and tax reform. Although the education package received broad support, the tax reform legislation, which included a personal income tax, did not.²⁴ One alternative to the personal income tax that was discussed at the time was broadening the sales tax base to include more services. As services’ share of the economy continued to increase, it was feared that the sales tax, which did not apply to most services, would not keep up; however, legislators were reluctant to extend the sales tax to more services following problems experienced in other states. Florida, for instance, repealed its sales tax on services soon after it was enacted when national advertisers boycotted the state and newspapers editorialized against the tax.²⁵ In Tennessee, a bill introduced in 1991 would have broadened the sales tax base to include services provided by professionals:

¹⁹ *Allied Stores of Ohio v. Bowers*, 358 U.S. 522, 79 S. Ct. 437 (1959).

²⁰ Lyons 2001.

²¹ Tennessee Department of Finance and Administration. January 1990 budget document estimate of \$4,423,500,000 versus actual accrual collections of \$4,190,136,000.

²² Roehrich-Patrick 2016.

²³ Tennessee State Board of Education 1991.

²⁴ Stair 2011.

²⁵ Nordheimer 1987.

The furnishing for consideration of *health, legal*, social, computer, *engineering, architectural*, surveying, *accounting*, research, management, public relations, motion picture production, general contractor, collection, credit reporting, tax return preparation, funeral, hair styling, secretarial, pest control, personnel supply, auctioneering, detective, security system, appraisal, dance instruction, sports instruction services, *real estate broker* services, insurance services, *stock broker* and commission dealer services, and *other similar professional services*. [Professions now subject to the professional privilege tax are bold.]

After both the income tax and the sales tax on services failed, a compromise was reached and the bill was amended and passed, becoming Public Chapter 529, Acts of 1992. The compromise included an increase in the sales tax, from 5.5% to 6% (\$230 million), a professional privilege tax (\$21 million), and other tax changes (\$25 million). See table 3. The professional privilege tax was a \$200 tax that individuals in 21 professions would have to pay annually.

Table 3. Estimated Revenue from Taxes Increased or Enacted by Public Chapter 529 Fiscal Year 1992-93

Tax	Estimated Revenue	Percent of Total
Sales Tax (5.5% to 6%)	\$ 230,000,000	83.3%
Professional Privilege Tax	21,470,200	7.8%
Sales Tax Vendor Compensation	20,500,000	7.4%
Litigation Tax	2,378,000	0.9%
Sec. of State Filing Taxes	1,771,800	0.6%
TOTAL	\$ 276,120,000	100%

Source: Fiscal note for Senate Bill 777, House Bill 868.

Tax proponents argued that a professional privilege tax would not harm the economy and would be easy to administer.²⁶ Although many professionals opposed the tax, they preferred it to a sales tax on their services.²⁷ Those with less income would pay more in taxes if they had to pay a sales tax on services. During discussions about the tax, several legislators argued that professionals make higher than average incomes, so some of the burden of raising the required revenue should fall on them. The legislators also knew that most of the tax burden would fall on out of state professionals who couldn't vote for them.²⁸

²⁶ John Lyell, lobbyist, phone interview with Michael Mount, June 1, 2016.

²⁷ Billy Stair, former senior policy advisor for Governor McWherter, phone interview with Michael Mount, July 14, 2016.

²⁸ Joe Huddleston, former Commissioner of Revenue, phone interview with Stan Chervin, June 10 2016.

The Choice of Which Professions to Tax was Partly Pragmatic, Partly Philosophical

It is difficult to objectively determine where to draw the line on which professions should be taxed and which shouldn't. In 1992, when the professional privilege tax was enacted in Tennessee, the choice of licensed professionals to be taxed was largely dollar driven—the state needed \$20 million to help fund the BEP. Using data supplied by the Department of Commerce and Insurance and the Department of Health, professions were added until the total number of professionals exceeded 100,000, the number needed to collect \$20 million from a \$200 tax.²⁹ But, according to comments by the Senate and House sponsors of the professional privilege tax legislation, the professionals they wanted to tax were the “big boys”³⁰ and higher earning “free standing professionals,”³¹ not “workers.”³² For instance, real estate principal brokers were included, but real estate affiliate brokers were excluded.³³ Physicians pay, not physician assistants. Dentists pay, not dental hygienists. The 21 professions they decided to tax were

- accountants,
- architects,
- attorneys,
- audiologists,
- chiropractors,
- dentists,
- engineers,
- investment advisers,
- landscape architects,
- lobbyists,
- optometrists,
- osteopathic physicians,
- pharmacists,
- physicians,

²⁹ Ibid.

³⁰ Representative Shelby Rhinehart, House floor discussion, February 22, 1992.

³¹ Senator Riley Darnell, Senate floor discussion, February 23, 1992.

³² Representative Shelby Rhinehart, House floor discussion, February 22, 1992.

³³ Tennessee Code Annotated, Section 67-4-1708.

- podiatrists,
- psychologists,
- real estate principal brokers,
- speech pathologists,
- stockbroker agents
- stock broker-dealers (stockbrokers), and
- veterinarians.

Although the privilege tax was estimated to collect \$21.5 million in 1992, actual collections were only \$13.0 million. The shortfall was in part because real estate broker affiliates were exempted after the \$21.5 million estimate was made. It also took a few years to properly administer the tax, which was enacted less than four months before it was first collected.

Athlete agents were added to the list of taxed professions in 1996,³⁴ bringing the total number of professions to its current 22. National Hockey League (NHL) and National Basketball Association (NBA) players were added in 2009,³⁵ but legislation was passed in 2014 exempting them from the tax.³⁶

While professionals like physicians and dentists are more obvious candidates for the tax, others are less so. Some professions that are not taxed earn higher incomes, on average, than some that are taxed. See table 4. For instance, nurse anesthetists are the highest earning profession that is not taxed, averaging \$153,690 in Tennessee, which is greater than that of 20 of the 22 professions that are taxed. Real estate brokers, accountants, and architect, who average \$49,530,³⁷ \$66,270, \$66,690, respectively, earn the least of the professions that are taxed.

Professions with low incomes like cosmetologists and barbers, which average \$28,420 and \$26,130, respectively, aren't taxed. Speech pathologist and audiologists, who average \$69,710 and \$67,570 in annual income, respectively, are taxed, but physical and occupational therapists, who average \$85,790 and \$80,040, are not taxed in Tennessee (or in any other state). In fact, legislation was introduced in 2003 to exempt audiologists and speech pathologists (Senate Bill 372 by Crutchfield and House Bill 286 by McDonald) and again in 2015

³⁴ Public Chapter 999, Acts of 1996.

³⁵ Public Chapter 530, Acts of 2009.

³⁶ Public Chapter 760, Acts of 2014. NHL players were exempted from the tax in 2014 and the exemption for the NBA players went into effect in 2016.

³⁷ This is the average for all real estate brokers in Tennessee; however, the professional privilege tax applies to principal brokers but not affiliates.

(Senate Bill 167 by Bowling and House Bill 601 by Durham). The fiscal note for the 2003 legislation estimated that state revenues would have decreased by \$530,000 per year if it had passed. By 2015, the fiscal note for legislation doing the same thing estimated a decrease of \$930,000 per year if it had passed, the difference being the increased number of audiologists and speech pathologists.

**Table 4. Average Annual Income of Professions in Tennessee, Including Those Subject to and Those Not Subject to the Professional Privilege Tax
Highest to Lowest Average Annual Income in 2015**

Profession	Taxed?	Average Annual Income (Tennessee)
Physicians	Yes	\$ 218,190
Dentists	Yes	176,080
Nurse Anesthetists	No	153,690
Podiatrists	Yes	139,970
Attorneys	Yes	125,530
Pharmacists	Yes	118,310
Optometrists	Yes	111,510
Investment Advisors	Yes	108,480
Nurse Practitioners	No	93,520
Physician Assistants	No	86,920
Physical Therapists	No	85,790
Engineers	Yes	85,549
Stockbroker Agents	Yes	84,620
Veterinarians	Yes	84,500
Psychologists	Yes	83,170
Landscape Architects	Yes	80,460
Occupational Therapists	No	80,040
Chiropractors	Yes	78,560
School Administrators	No	75,650
Genetic Counselor (US)	No	74,570
Nurse Midwives	No	74,390
Speech Pathologists	Yes	69,710
Audiologists	Yes	67,570
Architects	Yes	66,690
Accountants	Yes	66,270
Dental Hygienists	No	66,160
Court Reporters	No	65,650
Soil Scientists	No	63,400
Private Investigators	No	62,510
Athlete Agents	Yes	62,120
Insurance Agents	No	58,290
Registered Nurses	No	57,560
Dietitians/Nutritionists	No	53,950

Profession	Taxed?	Average Annual Income (Tennessee)
Real Estate Appraisers	No	51,830
Social Workers	No	51,630
Respiratory Therapists	No	49,700
Affiliate Real Estate Broker	No	49,530
Real Estate Broker - Principal	Yes	49,530
Funeral Directors	No	48,910
Professional Counselors (US)	No	48,790
Tax Return Preparer	No	48,050
Plumbers	No	47,930
Home Inspectors	No	46,750
Land Surveyor	No	44,400
Athletic Trainers	No	43,460
Alarm System Contractors	No	42,220
Interior Designers	No	41,560
Hearing instrument Specialists	No	40,180
Embalmers	No	39,880
Marital and Family Therapists	No	36,360
Massage Therapists	No	35,650
Locksmiths	No	33,780
Roofers	No	33,720
Collections Servicers	No	33,690
Dispensing Opticians	No	33,230
Pest Control Operator	No	32,560
Cosmetologists	No	28,420
Transitory Vendors	No	28,030
Barbers	No	26,130
Private Guards	No	26,020
Acupuncturists	No	unknown
Asbestos Contractor	No	unknown
Auctioneers	No	unknown
Body Piercers	No	unknown
Clinical Pastoral Therapists	No	unknown
Clinical Perfusionists	No	unknown
Contractors (Construction)	No	unknown
Electrologists	No	unknown
Fire Extinguisher Specialists	No	unknown
Geologists	No	unknown
Ginseng Dealers	No	unknown
Home Improvement	No	unknown
Lobbyists	Yes	unknown
Nursing Home Administrators	No	unknown
Orthopedic Physician Assistants	No	unknown

Profession	Taxed?	Average Annual Income (Tennessee)
Osteopathic Physicians	Yes	unknown
Pesticide Solicitors	No	unknown
Polygraph Examiners	No	unknown
Polysomnographers	No	unknown
Professional Employer Service	No	unknown
Reflexologists	No	unknown
Rental Location Agent	No	unknown
Scrap Dealers	No	unknown
Sprinklers - Responsible Employee	No	unknown
Stockbrokers	Yes	unknown
Tattoo Artists	No	unknown
Time-Share Acquisition Agent	No	unknown
Time-Share Salesperson	No	unknown

Sources: Selected professions are from Tennessee Code Annotated. Occupational Employment Statistics, US Bureau of Labor Statistics, 2016.

The list of professions taxed varies across the other five states that levy a professional privilege tax, but three of them, Alabama, Delaware, North Carolina also tax real estate brokers, and four, Alabama, Connecticut, Montana, North Carolina, also tax attorneys. In fact, two, Connecticut and Montana, tax only attorneys. Alabama and North Carolina are the only two besides Tennessee that taxes accountants, architects, chiropractors, dentists, engineers, optometrists, physicians, podiatrists, and veterinarians. Alabama and Delaware are the only other two that tax stockbrokers. And Tennessee is the only state that taxes athlete agents, audiologists, investment advisers, lobbyists, pharmacists, psychologists, and speech pathologists. See appendix E for a complete list of the professions taxed by the states.

Most of the Professional Privilege Tax's Burden Falls on Non-Tennesseans

Most of the tax burden in Tennessee falls on professionals that are not state residents. Of the 220,050 professionals who pay the tax, two-thirds (141,048) live outside the state, and four-fifths (83%) of those are stockbrokers.³⁸ Besides stockbrokers, most athlete agents (84%), architects (56%), and engineers (51%) that pay Tennessee's professional privilege tax live outside the state. See table 5. Senate Bill 1919 by Bowling, House Bill 1951 by Hazlewood, would have exempted 705 out-of-state professionals, specifically those who are licensed or otherwise allowed to practice in another state, who do not maintain a residence or place of

³⁸ Stockbroker agents are typically registered in all 50 states. It would be administratively difficult for them to avoid the tax by not registering in Tennessee; they would have to check the residence of all of their clients to ensure that none of them reside in Tennessee.

business in the state, and who do not work in Tennessee in one of the taxed professions. The bill's fiscal note estimated a decrease in state revenue in excess of \$282,000. It would be difficult to administer this change because it would be hard to determine or prove that a person was not working in the state. Exempting all out-of-state professionals would be administratively easier, but there would be a much higher loss of state revenue (\$56 million).

Table 5. Number of Professionals Subject to the Professional Privilege Tax Residing in or out of Tennessee, Fiscal Year 2014-15

Profession	In-State		Out-of-State		Total
	Number	Percent	Number	Percent	
Accountants	8,501	84%	1,629	16%	10,130
Architects	1,333	44%	1,708	56%	3,041
Athlete Agents	16	16%	86	84%	102
Attorneys	17,818	82%	3,850	18%	21,668
Audiologists	331	85%	60	15%	391
Chiropractors	1,005	91%	95	9%	1,100
Dentists	3,136	87%	462	13%	3,598
Engineers	5,595	49%	5,914	51%	11,509
Investment Advisors	294	54%	251	46%	545
Landscape architects	162	53%	141	47%	303
Lobbyists	332	78%	92	22%	424
Optometrists	972	83%	206	17%	1,178
Osteopathic Physicians	738	65%	401	35%	1,139
Pharmacists	7,595	71%	3,101	29%	10,696
Physician	15,678	76%	5,042	24%	20,720
Podiatrists	212	86%	35	14%	247
Psychologists	1,204	89%	149	11%	1,353
Real Estate Broker - Principals	2,817	84%	547	16%	3,364
Speech Pathologists	2,073	90%	229	10%	2,302
Stockbroker Agents	7,376	6%	115,133	94%	122,509
Stockbrokers	73	5%	1,538	95%	1,611
Veterinarians	1,741	82%	379	18%	2,120
Total	79,002	36%	141,048	64%	220,050

Sources: Tennessee Fiscal Review Committee, Fiscal Note of Senate Bill 777. Tennessee Department of Revenue.

The Tax Rate was Increased to \$400 in 2002

The state was in an economic recession in early 2001, and tax collections for fiscal year 2001-02 were \$477 million less than what was estimated in January 2001. Non-recurring tobacco settlement money was used to balance the previous year's budget so a more permanent solution was needed to raise revenue. Once again an income tax was proposed, but amid protests, it failed.³⁹ Following a partial government shutdown, the professional privilege tax was doubled from \$200 to \$400 in 2002 to raise \$24.9 million of a \$933.2 million tax increase. The total increase also included an increase in the sales tax rate from 6% to 7% and increases in several other taxes.⁴⁰ See table 6.

Table 6. Estimated Revenue from 2002 Tax Increase
Fiscal Year 2002-03

Tax	Estimated Revenue	Percent of Total
Sales Tax (6% to 7%, except food)	\$ 600,395,833	64.3%
Excise Tax (6% to 6.5%)	77,400,000	8.3%
Business Tax (State Retains Increase)	73,333,000	7.9%
Excise Tax (No Accelerated Depreciation)	50,000,000	5.4%
Single Article Sales Tax	38,613,167	4.1%
Cigarettes (13 to 20 cents/pack)	32,818,000	3.5%
Professional Privilege Tax	24,946,200	2.7%
Vending Machine Sales Tax	16,675,000	1.8%
Commercial Vehicle Registration	8,101,000	0.9%
Coin-operated Amusement	3,375,000	0.4%
Including Sales Tax in Retail Price	2,643,000	0.3%
Spirits (10%; \$4.00 to \$4.40/gallon)	2,172,542	0.2%
Beer tax (10%; \$3.90 to \$4.29 per bbl.)	1,487,333	0.2%
Wholesale tobacco (10%; 6% to 6.6%)	678,500	0.1%
Wine (10%; \$1.10 to \$1.21/gallon)	596,083	0.1%
TOTAL	\$ 933,234,658	100%

Source: Tennessee Fiscal Review Committee, Fiscal Note on Senate Bill 3110 (House Bill 3046).

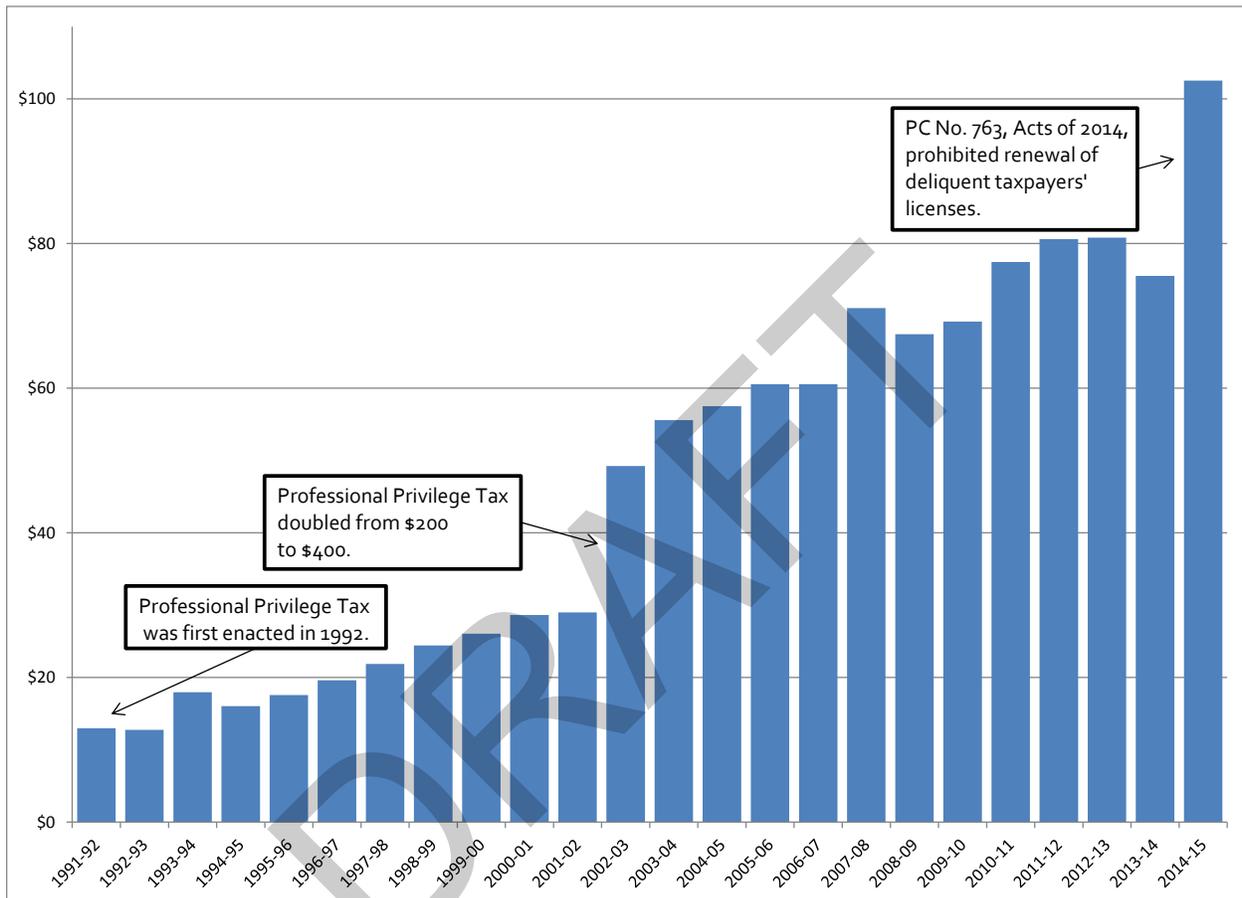
Collections increased by 70%, from \$29.0 million to \$49.2 million, when the tax rate was doubled. In an effort to improve collections, a bill was passed requiring the Commissioner of Revenue to send a list of delinquent taxpayers to licensing boards and to suspend any license

³⁹ Senate Bill 2646 by Cooper, House Bill 2957 by Head (2002).

⁴⁰ Public Chapter 856, Acts of 2002.

or registration renewal of any professionals who fail to pay their professional privilege taxes.⁴¹ Collections subsequently increased 36%, from \$75.5 million in fiscal year 2013-14 to \$102.5 million in fiscal year 2014-15. See figure 1.

**Figure 1. Professional Privilege Tax Collections in Tennessee
Fiscal Years 1991-92 to 2014-15 (in millions)**



Source: Tennessee Department of Revenue.

Currently, the tax raises \$88 million per year, but it's levied on only 220,050 of the more than 700,000 licensed or registered professionals in the state.⁴² If it were applied to all the professions registered and licensed by the Department of Commerce and Insurance and the Department of Health, the tax would raise \$280 million per year. By expanding the tax to all

⁴¹ Chapter 763, Public Acts of 2014.

⁴² \$88 million is arrived at multiplying \$400 by 220,050 professionals subject to the tax. The estimated 700,763 licensed or registered professionals in Tennessee is the sum of 410,090 (Department of Commerce and Insurance 2016), 268,479 (Department of Health 2014), 21,668 (attorneys), 424 (lobbyists), and 102 (athlete agents).

professionals registered and licensed by these departments, the tax could be lowered to \$126 and raise the same \$88 million. But this would subject lower-earning professions like barbers and cosmetologists to the tax.

Exempting professions that are currently taxed would result in the loss of revenue each year, depending on which professions were exempted. For example, because there are many more stockbroker agents (122,509) than there are athlete agents (102), exempting stockbroker agents would decrease state tax revenue by \$49 million, more than half the revenue, but exempting athlete agents by only \$40,800. Table 7 shows how much state tax revenue would decrease per year, if other professions were exempted from the tax.

Table 7. Estimated Revenue Lost if Professions Currently Taxed are Exempted
2016

Profession	Estimated Tax Revenue Decrease
Accountants	\$ 4,052,000
Architects	1,216,400
Athlete Agents	40,800
Attorneys	8,667,200
Audiologists	156,400
Chiropractors	440,000
Dentists	1,439,200
Engineers	4,603,600
Investment Advisors	218,000
Landscape Architects	121,200
Lobbyists	169,600
Optometrists	471,200
Osteopathic Physicians	455,600
Pharmacists	4,278,400
Physician	8,288,000
Podiatrists	98,800
Psychologists	541,200
Real Estate Broker- Principals	1,345,600
Speech Pathologists	920,800
Stockbroker Agents	49,003,600
Stockbrokers	644,400
Veterinarians	848,000
Total	\$ 88,020,000

Source: TACIR staff calculation based on Tennessee Department of Revenue counts of professionals.

Inequities within Professions

Not only do average incomes vary across professions, incomes of individual professionals vary within professions. For instance, real estate brokers make \$49,530 on average, but 10% make less than \$19,400. Psychologists average \$83,170, but 10% make less than \$23,980. See Table 8.

Table 8. Incomes of Professionals at Various Percentiles, 2015.

Profession	Annual Income of Professionals at Various Percentiles				
	10%	25%	50%	75%	90%
Accountants	\$37,550	\$47,040	\$58,760	\$75,310	\$99,510
Architects	\$32,880	\$48,100	\$63,410	\$81,370	\$103,750
Athlete Agents	\$32,240	\$36,500	\$55,340	\$79,980	\$107,320
Attorneys	\$50,520	\$70,360	\$105,890	\$153,180	unknown
Audiologists	\$52,280	\$57,790	\$66,290	\$75,010	\$81,710
Chiropractors	\$37,010	\$43,230	\$54,370	\$105,720	\$140,700
Dentists	\$94,400	\$112,560	\$150,070	unknown	unknown
Engineers (US)	\$55,110	\$69,680	\$90,060	\$115,620	\$145,320
Investment Advisors	\$36,480	\$51,490	\$75,760	\$152,900	unknown
Landscape Architects	\$36,240	\$64,150	\$80,620	\$104,760	\$121,410
Lobbyists	unknown	unknown	unknown	unknown	unknown
Optometrists	\$54,220	\$82,280	\$106,850	\$140,840	\$162,770
Osteopathic Physicians	unknown	unknown	unknown	unknown	unknown
Pharmacists	\$84,410	\$108,360	\$120,920	\$135,210	\$152,460
Physicians (US)	\$60,940	\$132,070	unknown	unknown	unknown
Podiatrists	\$64,830	\$90,820	\$120,670	\$153,530	unknown
Psychologists	\$23,980	\$70,190	\$94,580	\$102,960	\$108,510
Real Estate Brokers	\$19,400	\$32,090	\$40,910	\$65,780	\$77,880
Speech Pathologists	\$41,490	\$51,570	\$66,650	\$87,940	\$103,740
Stockbroker Agents	\$29,110	\$36,710	\$58,110	\$102,750	\$179,810
Stockbrokers	unknown	unknown	unknown	unknown	unknown
Veterinarians	\$44,600	\$64,670	\$78,580	\$96,130	\$119,350

Source: Occupational Employment Statistics, US Bureau of Labor Statistics, 2015

Just as it is difficult to objectively determine which professions should be taxed, it's also difficult to decide which individuals should be exempted. Tennessee exempts inactive or retired professionals,⁴³ those called into active military service from a reserve or National

⁴³ Tennessee Code Annotated, Section 67-4-1708(a).

Guard unit for more than six months,⁴⁴ non-professional lobbyists,⁴⁵ and medical practitioners licensed to volunteer at free health clinics.⁴⁶ In addition to already exempted individuals, one bill in 1996 would have addressed the concern that incomes of professionals can vary significantly by exempting individuals with incomes of less than \$5,000 per year derived from their profession.⁴⁷ The General Assembly has also considered bills that did not pass that would have exempted

- persons who only practice professionally on volunteer basis for 501(c)(3) organization,⁴⁸
- health care providers serving in a residency or in graduate school,⁴⁹
- persons licensed in this state to practice a healing art or any branch thereof who are officers in the commissioned medical corps of the armed forces who are exempt from registration with the division of health related boards,⁵⁰
- a medical practitioner who exclusively provides pro bono services for those persons receiving services from tax-exempt charitable organizations,⁵¹
- dentists over age 75,⁵² and
- the disabled and not actively employed.⁵³

Although state employees were exempted from the tax in 2002,⁵⁴ they were subjected to the tax once again in 2003, and state agencies were authorized to pay the tax for their employees.⁵⁵

⁴⁴ Tennessee Code Annotated, Section 67-4-1708(c).

⁴⁵ Tennessee Code Annotated, Section 3-6-307.

⁴⁶ Tennessee Code Annotated, Section 67-4-1710.

⁴⁷ Senate Bill 1654 by Gilbert, House Bill 1559 by Armstrong (1996).

⁴⁸ Senate Bill 26 by McNally (2003).

⁴⁹ Senate Bill 2851 by Person and Curtis, House Bill 3359 by Odom (2004).

⁵⁰ Senate Bill 2782 by Burchett, House Bill 3013 by Dunn (2010).

⁵¹ Senate Bill 2491 by Barnes, House Bill 2572 by Johnson C. (2010).

⁵² Senate Bill 243 by Haynes House Bill 1314 by West (2007).

⁵³ Senate Bill 1258 by Cohen, House Bill 1202 by Fowlkes (1995).

⁵⁴ Chapter 856, Public Acts of 2002

⁵⁵ Chapter 418, Public Acts of 2003. The Tennessee Attorney General wrote in Opinion Number 03-002 that the exemption for state employees "violates the doctrine of intergovernmental tax immunity by impermissibly favoring state employees over federal employees, and thus it cannot be implemented as written." According to the fiscal note for Public Chapter 592, Acts of 2004, the state recognized that it could not exempt state employees

Other states also exempt certain individuals from the professional privilege tax. In Alabama, blind people are exempt up to \$75;⁵⁶ disabled veterans and World War II veterans are exempt from license taxes in excess of \$25 and \$35, respectively.⁵⁷ North Carolina exempts people aged 75 years or older, blind people and people practicing the art of healing if the person is an adherent of an established church or religious organization and confines the healing practice to prayer or spiritual means.⁵⁸

Depending on How Their Businesses are Organized, Professionals May Have to Pay Franchise and Excise Taxes as Well as Professional Privilege Taxes

Professionals can work in a variety of business organizations as a salaried employee or as an owner of sole proprietorships, general partnerships, corporations, limited liability corporations (LLCs), limited partnerships (LPs), or limited liability partnerships (LLPs). Salaried employees can deduct the professional privilege tax on the schedule A of their federal income tax return if their miscellaneous deductions exceed 2% of their adjusted gross income and their itemized deductions exceed the standard deduction. Professionals who own sole proprietorships or general partnerships are not responsible for franchise and excise taxes, but the professional privilege tax can be a deductible expense against business income on their federal tax return or if not used as a business deduction they can deduct the tax as a miscellaneous deduction.

Although professionals that own corporations, LLCs, LPs, or LLPs can deduct professional privilege taxes against business income, they may owe both the professional privilege tax and franchise and excise taxes. When the professional privilege tax was first passed in 1992, few professionals that paid the tax organized as LLCs, LPs, and LLPs, which were not liable for franchise and excise taxes at that time. However, in 2000, the General Assembly passed legislation extending franchise and excise taxes to limited liability entities.⁵⁹ This raises concerns that professionals who own corporations, LLCs, LPs, or LLPs are double-taxed because they pay both professional privilege taxes as individuals and franchise and excise taxes as business owners. See table 9. In other instances where double-taxation is a concern, a common approach is to provide a credit for one of the taxes against the others. For instance, in Tennessee, the amount paid in personal property taxes can be taken as a credit against the business tax, which is a tax on the gross receipts of businesses.⁶⁰

without exempting federal employees, and exempting federal employees would have decreased state tax revenue by more than \$1,150,000 per year.

⁵⁶ Code of Alabama, Section 40-12-330.

⁵⁷ Code of Alabama, Sections 40-12-341 and 371.

⁵⁸ General Statutes of North Carolina, Section 105-41(b).

⁵⁹ Chapter 982, Public Acts of 2000.

⁶⁰ Tennessee Code Annotated, Section 67-4-713.

Table 9. Tax Treatment of Professionals by How Business is Organized

Impact of Tax on all Taxed Professionals By Type of Situation			
	Salaried Employee	Owner of Sole Proprietorship or General Partnership	Owner of Corporation, LLC, LP, or LLP
Subject to franchise and excise tax	No	No	Yes
Professional privilege tax can be a deductible expense against business income on federal tax return.	No	Yes	Yes
Professional privilege tax can be deducted on schedule A of federal income tax return if miscellaneous deductions exceed 2% of adjusted gross income.	Yes	Yes but not if used as a business deduction	No

Sources: Tennessee Code Annotated, Sections 67-4-2001 et seq. 26 US Code, Sections 67 and 164.

DRAFT

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